SUPREME COURT, U. S.

No. 73-1017

In the Supreme Court of the United States

OCTOBER TERM, 1973

Supreme Court, U. S.
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MICHAEL RODAK, JR.

UNITED STATES OF AMERICA, PETITIONER

v.

WALT DISNEY PRODUCTIONS

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

The Solicitor General, on behalf of the United States, petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Ninth Circuit in this case.

OPINIONS BELOW

The memorandum opinion of the District Court (Appendix A, *infra*, pp. 1a-9a) is reported at 327 F. Supp. 189. The opinion of the court of appeals (Appendix B, *infra*, pp. 10a-16a) is reported at 480 F. 2d 66.

JURISDICTION

The judgment of the court of appeals was entered on May 29, 1973 (Appendix C, *infra*, p. 17a). A petition for rehearing and suggestion for rehearing *en banc* was denied on July 31, 1973 (Appendix D, *infra*, pp. 18a-19a). By order dated October 18, 1973, Mr. Justice Douglas extended the time for filing a petition for a writ of certiorari to and including December 28, 1973. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Sections 38, 46 and 48(a)(1)(A) of the Internal Revenue Code of 1954 allow an investment credit against income tax equal to a maximum of seven percent of the costs incurred in the acquisition or construction of "tangible personal property." The question presented is whether the costs of producing a motion picture for theatrical or television exhibition are costs incurred in the acquisition or construction of "tangible personal property" within the meaning of the latter provision so as to be eligible for the investment credit.

STATUTES AND REGULATIONS INVOLVED

The pertinent provisions of the Internal Revenue Code of 1954 and of the Treasury Regulations on Income Tax (1954 Code) are set forth in Appendix E, *infra*, pp. 20a-30a.

STATEMENT

Respondent is a California corporation which produces and distributes motion pictures. By late 1961, respondent had produced more than 100 pictures, positive prints of which were exhibited either in motion picture theaters or on television (Appendix A, *infra*, pp. 1a-2a; R. 892-893).[1]

The production of a motion picture involves a wide variety of expenditures culminating in the creation of an original negative, which is then used to make a matrix. The matrix is in turn used to make positive prints to be rented or sold for exhibition to the public (Appendix A, *infra*, p. 2a; Ex. 11, p. 8). The expenditures involved in the production of a motion picture include: (1) the cost of acquiring or creating literary property; (2) salaries to the producer, director, writers, technicians, wardrobe personnel and set decorators; (3) salary to regular cast and extras; (4) costs of set construction and costumes; (5) special effects; (6) music; (7) transportation to and from location; (8) film; (9) laboratory and processing of work prints; (10) living expenses on location; and (11) an allocable share of employee benefits and general studio overhead (R. 884-887).

During the period January 1, 1962, through September 29, 1962, respondent incurred $1,416,573 of

[1] "R." references are to the duplicated volumes of the record on appeal. We have lodged a copy of each volume with the Clerk of this Court. We have also lodged a copy of Exhibit 11 (Amended Stipulation of Facts) with the Clerk.

such costs in the production of eight motion pictures (Appendix A, *infra*, pp. 1a-2a). On its income tax return for its taxable year ended September 29, 1962, respondent claimed an investment credit under Sections 38, 46 and 48 of the Internal Revenue Code of 1954 of $99,160, which was equal to seven percent [2] of its motion picture production costs of $1,416,573 (Appendix A, *infra*, p. 2a).

The Commissioner disallowed the credit on the ground that the costs of producing the motion pictures did not constitute the acquisition or construction of "tangible personal property" within the meaning of Section 48(a)(1)(A). The Commissioner's disallowance of the claimed credit was on the authority of Treasury Regulations, Section 1.48-1(f). This Regulation specifically provides that motion picture production costs are attributable to the acquisition of intangible property and are therefore ineligi-

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[2] Generally, the amount of the credit is equal to seven percent of a taxpayer's "qualified investment" (Section 46(a)(1)), which is defined as "the applicable percentage" of the basis of "new section 38 property" (*i.e.*, property constructed, reconstructed, erected or acquired by the taxpayer (Section 46(c)). The "applicable percentage" varies with the useful life of the property, determined as of the time it is placed in service by the taxpayer. Property with a useful life of eight years or more is fully taken into account in computing the "qualified investment." If the useful life is less than eight years, but more than four, a lesser percentage of the basis is employed in computing the investment credit (Section 46(c)(2)). Although respondent amortized most of the costs of its motion pictures over a three-year period, it estimated the useful life of the negatives to be eight years or more, thereby enabling it to claim the maximum credit.

ble for the investment credit (R. 891; Ex. 11, pp. 3-4).

Because motion picture negatives are "capable of being seen and touched," the district court concluded that they were "tangible personal property" within the meaning of Code Section 48(a)(1)(A). It held the Commissioner's Regulation invalid and included all of respondent's motion picture costs[3] in its investment credit base (Appendix A, *infra*, pp. 6a-9a). The court of appeals affirmed. Relying upon certain statements in the legislative history with respect to the restoration of the investment credit in the Revenue Act of 1971, it held that the Commissioner's Regulation was inconsistent with the purpose of the investment credit (Appendix B, *infra*, pp. 10a-16a).

REASONS FOR GRANTING THE WRIT

1. The decision of the court of appeals allowing the investment credit on virtually all of the costs of motion picture production from 1962 through 1969 of films made for both theatrical and television exhibition will result in a potential loss of tax revenues to the federal government of between 400 and 450 million dollars.[4]

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[3] The district court excluded from the investment credit base one minor aspect of respondent's costs, the cost of rejected film footage (Appendix A, *infra*, pp. 8a-9a). The court of appeals, however, allowed the investment credit on such costs (Appendix B, *infra*, p. 16a).

[4] Although the present case involves a claim of only $99,160 for a single year, respondent has indicated that for its taxable

The Internal Revenue Service, on the basis of information with respect to the addresses of more than 700 domestic motion picture producers, has concluded that approximately 75 percent of them will be able to sue in the Ninth Circuit, because their offices or principal places of business are in California. The investment credit is a direct offset against income taxes otherwise payable by firms who can claim the credit. The Service estimates that comparable and potential claims for the investment credit which the court of appeals decision allows by the major motion picture producers for open tax years during the period 1962-1969 would create a potential loss of federal tax revenues of almost half a billion dollars.[5]

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years 1962 through 1969, its motion picture costs were at least $100 million, upon which it has claimed the maximum seven percent credit, which totals at least $7 million, excluding interest. See page 5 of an affidavit dated November 14, 1972, of John Cooley Baity, one of respondent's counsel in the court of appeals. This affidavit was filed in the court of appeals in support of a motion for a preference in calendaring the oral argument. We have lodged a copy of this affidavit with the Clerk.

[5] In addition to the instant case, the same issue is present in at least five other cases now pending in the Court of Claims, all of which were brought after the decision of the district court in this case. The taxpayers and the amounts at issue are as follows: *RCA Corp.* v. *United States*, No. 142-73 ($4,223,743 for 1965-1966); *RCA Corp.* v. *United States*, No. 675-71 ($352, 682 for 1964); *National Broadcasting Co.* v. *United States*, No. 676-71 ($485,287 for 1962-1963); *Columbia Broadcasting System, Inc.* v. *United States*, No. 679-71 ($1,141,210 for taxable year ended January 2, 1965); and *Esquire, Inc.* v. *United States*, No. 169-73 ($34,736 for taxable year ended March 31, 1966).

Although the impact of the Ninth Circuit's decision may be limited to the period 1962 through 1969,[6] it will nevertheless, as this Court stated only last Term under similar circumstances, "afford a precedent for the tax treatment of substantial sums." *United States* v. *Chicago, Burlington & Quincy R.R. Co.*, October Term, 1972, No. 72-90 (decided June 4, 1973) (Slip op. 4).[7]

In view of the importance of the issue and the fact that the decision of the Ninth Circuit will control the major portion of similar claims by the motion picture industry, there is no occasion to await the development of a possible conflict of decisions through future litigation. The decision below itself will have an enormous impact upon the federal fisc, since it

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[6] The investment credit generally was terminated for property acquired after April 18, 1969, and for property the physical construction, reconstruction, or erection of which began after April 18, 1969. See Code Section 49, added by Section 703(a), Tax Reform Act of 1969, P.L. 91-172, 83 Stat. 487. It was restored, and to some extent modified, by the addition to the Code of Section 50 by Section 101(a) of the Revenue Act of 1971, P.L. 92-178, 85 Stat. 497. In the legislative history of the restoration of the investment credit in the Revenue Act of 1971 (H. Rep. No. 92-533, 92d Cong., 1st Sess.; S. Rep. No. 92-437, 92d Cong. 1st Sess.), Congress apparently indicated a desire to extend the investment credit by carving out a legislative exception under which motion picture and television film costs would be deemed attributable to the construction of tangible personal property.

[7] There, as here, the issue had been apparently settled by legislation governing subsequent years. This fact, however, did not minimize the importance of the question for purposes of review by this Court because of the substantial amounts at stake for the period with respect to which the issue remained unsettled.

will permit a direct offset from tax liability of an amount equal to a maximum of seven percent of the entire overhead of most American film producers for the years 1962 through 1969. A decision with such far reaching impact calls for review by this Court now.

2. In extending the investment credit for motion picture production costs, the decision below is contrary to the Congressional purpose in originally enacting the investment credit. The credit was introduced as part of the Revenue Act of 1962, in order to stimulate the domestic economy and to improve the balance of payments deficit by encouraging the modernization and expansion of the nation's productive facilities and by reducing "the net cost of acquiring new equipment." [8] Nothing in the history of the Revenue Act of 1962, however, suggests that Congress also intended this legislation to encourage the production of entertainment vehicles such as motion pictures.

Quite the contrary is true. The legislative history shows that Congress did not intend the investment credit to apply to costs of purchasing personal services necessary for the creation of artistic or literary properties such as a motion picture. In discussing the requirements for eligibility, both the House and Senate Committee Reports accompanying the 1962 Act stated that "Intangible property, such as patents

[8] S. Rep. No. 1881, 87th Cong., 2d Sess., p. 11; see also H. Rep. No. 1447, 87th Cong., 2d Sess., pp. 7-9; and H. Conf. Rep. No. 2508, 87th Cong., 2d Sess., p. 14.

and copyrights, does not qualify as section 38 property." S. Rep. No. 1881, *supra*, p. 154; H. Rep. No. 1447, *supra*, p. A18.[9]

Moreover, the very language of the investment credit provisions confirms the Congressional understanding that the credit was not to apply to motion picture production costs, other than the cost of facilities such as lights, cameras, and similar equipment. The credit only applies to "new section 38 property." With respect to property created by the taxpayer's own efforts, this term is defined in Section 48(a)(1)(A) and (b) as "tangible personal property" the "*construction, reconstruction, or erection* of which is completed by the taxpayer after December 31, 1961" (emphasis added).

By using the terms "construction," "reconstruction," or "erection," Congress limited eligibility for the credit to property the creation of which would

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[9] Congress was not unaware when it limited the investment credit to tangible property that motion pictures were intangible property. Significantly, in 1962, in its consideration of the legislation proposing the investment credit, the Senate Finance Committee heard testimony from Eric Johnston, President of the Motion Picture Association of America (Senate Hearings before the Committee on Finance on H.R. 10650, 87th Cong., 2d Sess., pp. 3518-3524. He stated (p. 3519): "If our product was a toaster or a washer, or any other patented or processed commodity, it would be clear that we should be treated like all others engaged in a trade or business. But our product is a motion picture—entertainment, art, an image of light and shadow projected on a screen." Although detailed legislative proposals were suggested to assist the industry, nothing was enacted, much less even reported out of committee. Notably, no proposal was made to extend the investment credit to motion picture production costs.

literally fit within the "ordinary, everyday senses" of these words.[10] The process by which a photoplay is superimposed upon celluloid in order to create a completed negative is neither "construction" nor "erection" in the normal sense of these terms. One does not "construct" or "erect" a motion picture; one "produces" it. A motion picture is not "new section 38 property" as the statute defines that term.

If Congress had intended motion picture production costs to be eligible for the investment credit, it knew how to say so in unequivocal terms. This is shown by a bill (H.R. 7786, 88th Cong., 1st Sess.), introduced on July 25, 1963, by Representative King of California, then the second ranking majority member of the House Committee on Ways and Means. The bill, which was never reported, would have amended the definition of "section 38 property" set forth in Code Section 48(a) to include "motion picture and television films and tapes which are produced within the United States." See 109 Cong. Rec. 13379.

3. In the light of the policy of the investment credit as originally enacted, the Treasury Regulation, struck down by the decision below, is entirely consistent with the Congressional understanding that motion picture production costs are not eligible for the credit. Treasury Regulations, Section 1.48-1(f), provides as follows:

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[10] See, *e.g.*, *Malat* v. *Riddell*, 383 U.S. 569, 571; *Crane* v. *Commissioner*, 331 U.S. 1, 6; *Hanover Bank* v. *Commissioner*, 369 U.S. 672, 687-688; *Commissioner* v. *Korell*, 339 U.S. 619, 627-628.

> * * * Intangible property, such as patents, copyrights, and subscription lists, does not qualify as section 38 property. The cost of intangible property, in the case of a patent or copyright, includes all costs of purchasing or producing the item patented or copyrighted. *Thus, in the case of a motion picture or television film or tape, the cost of the intangible property includes manuscript and screenplay costs, the cost of wardrobe and set design, the salaries of cameramen, actors, directors, etc., and all other costs properly includible in the basis of such film or tape.* In the case of a book, the cost of the intangible property includes all costs of producing the original copyrighted manuscript, including the cost of illustration, research, and clerical and stenographic help. * * * [Emphasis added.]

Quite apart from the teachings of this Court that a Treasury Regulation must be sustained unless unreasonable or plainly contrary to the legislative mandate (*United States* v. *Correll*, 389 U.S. 299, 306-307; *Commissioner* v. *South Texas Co.*, 333 U.S. 496, 501),[11] the Regulation in question correctly recognizes the nature and relative values of the property interests inherent in the ownership of a motion picture, as reflected in the decisions of this Court and

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[11] Moreover, in view of the special delegation to the Commissioner in Section 38(b), Appendix E, *infra*, p. 20a, to "prescribe such regulations as may be necessary to carry out the purposes [of the investment credit]," the Regulation in question is entitled to more than the usual great weight accorded such administrative constructions and should not be overturned unless clearly unlawful. *Brewster* v. *Gage*, 280 U.S. 327, 336; *Lucas* v. *American Code Co.*, 280 U.S. 445, 449.

others. In invalidating the above-quoted Regulation, the decision of the court of appeals is contrary to virtually every existing authority dealing with the nature of the interest a motion picture represents.

Theatrical or television films, like other forms of literary property, consist of at least two distinct types of property rights: the negative, a celluloid film which is tangible; and the photoplay, the images impressed upon the celluloid and the sound track, and the accompanying rights to distribute and exhibit that artistic creation, which are intangible. *Pickford Corp.* v. *De-Luxe Laboratories*, 161 F. Supp. 367 (S.D. Cal.); *King Bros. Productions, Inc.* v. *RKO Teleradio Pictures, Inc.*, 208 F. Supp. 271 (S.D. N.Y.); *Italiani* v. *Metro-Goldwyn-Mayer Corp.*, 45 Cal. App. 2d 464, 466, 114 P. 2d 370, 372. The latter aspect of ownership is a copyright because it includes the right to make copies of the fruits of the intellectual and artistic endeavors, to publish and exploit them commercially, and to preclude all others from duplicating the work. These rights have been universally held to be intangible. *Millar* v. *Taylor*, 4 Burr. 2303, 2396, 98 English Reports (Reprints) 201, 251; *Stephens* v. *Cady*, 55 U.S. 528; *American Tobacco Co.* v. *Werckmeister*, 207 U.S. 284, 298. Moreover, these intangible rights known as copyrights have been long held to be separate and distinct from the material object which is copyrighted and even from the particular physical means utilized to create the copies. *Stephens* v. *Cady, supra; Stevens* v. *Gladding*, 58 U.S. 447, 452; 17 U.S.C. 27.

In attributing all of the motion picture production costs to the tangible celluloid film, the court of appeals failed to perceive that the essential value of a motion picture arises out of its intangible aspects, particularly the exclusive right to make copies of and to exploit the intellectual and artistic endeavor which has been embodied in the negative.[12] In recognition of this fact, the Second Circuit stated in *Misbourne Pictures Limited* v. *Johnson*, 189 F. 2d 774, 776: "The essential subject matter of the contract was the rights of distribution granted to Goldwyn, not possession of the negative. The latter without the former would have been of relatively little value to either party." For this reason, if for no other, the greatest part of the cost of a produced film (or video tape) is properly attributable to the intangible photoplay. And it is precisely in recognition of the fact that the value of a motion picture resides in its intangible element that the Regulations treat motion picture production costs as an investment in nonqualifying

[12] The practice with respect to depreciation of motion pictures similarly recognizes that the chief value of such films lies in the right to exploitation. Depreciation is computed under the "income forecast" method and not by reference to the physical life of the negative. See Rev. Rul. 60-358, 1960-2 Cum. Bull. 68. The motion picture industry itself recognizes the propriety of this method. See American Institute of Certified Public Accountants, *Accounting for Motion Picture Films*, pp. 10-12 (1973 ed). See also *Kiro, Inc.* v. *Commissioner*, 51 T.C. 155, 172-173.

intangible property.[13] Indeed, to attribute the costs incurred in producing a motion picture to the tangible negative may be analogized to attributing the costs of litigation to the tangible transcript of a trial or the

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[13] With the exception of this case, the motion picture industry itself has always recognized that the essential value of a motion picture is attributable to the intangible property rights. Indeed, it so argued in *Michael Todd Company* v. *County of Los Angeles*, 371 P.2d 340 (Cal. Sup. Ct.). The question in that case was whether a local *ad valorem* property tax assessment on motion pictures could include the value of the copyright and other intangible rights inherent in the film. In its *amicus curiae* brief filed on behalf of the studio, the Association of Motion Picture Producers argued (pp. 17-18):

> Concededly, the essential value in motion picture negatives arises out of the copyright, that is, the owner's exclusive right to make copies of and to exploit the intellectual and artistic endeavor which has been embodied in the negative. Judicial notice was taken of this fact in *Pickford Corporation* v. *De-Luxe Laboratories*, 161 Fed. Supp. 367, 369 (S.D. Cal.) and it is also conceded by the stipulated fact in the present case that the value of the negatives, in the hands of one who did not possess the copyright would be only $1,000 for salvage uses while the assessed value of the negatives, in which assessment the right to use the copyright was taken into account, was $1,500,000. Whatever the semantics employed which attempt to justify such an assessment, the ultimate result is to levy a tax on the entire bundle of intangible rights which flow from the copyright itself and, as a consequence, to tax the copyright to the owner.

Although the California Supreme Court held against the motion picture production company for other reasons, it concurred with the industry's argument that the principal value in a motion picture lies in its intangible properties. See 371 P.2d at 343-347. Subsequently, the taxing statute (Cal. Rev. and Tax Code § 988) was amended to avoid the result in the case.

cost of a share of stock to the tangible certificate.

In attempting to minimize the copyright aspects of a motion picture and their attendant value, the court of appeals stated that the Regulation attributes all production costs "to the intangible copyright eventually procured on the positive print" (Appendix B, *infra*, p. 12a). But the copyright protections inherent in the creation of a motion picture arise before and not after the striking of the first print. As the Second Circuit long ago held in the case of motion pictures, a common-law copyright attaches to the "intellectual conception of the photoplay expressed in actions." *Universal Film Mfg. Co.* v. *Copperman*, 218 Fed. 577, 579, certiorari denied, 235 U.S. 704. In ignoring this common-law copyright which exists independent of any statutory copyright subsequently obtained, the court of appeals misconceived the nature of respondent's rights and their accompanying value in its motion pictures.[14]

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[14] The court of appeals further erred in analogizing the completed negative which is used to strike copies of a motion picture to a production machine in an automobile factory (Appendix B, *infra*, p. 13a). Whether or not the machine is patented, the court observed that the cost to produce it would be eligible for the investment credit. Focusing upon the print-making process, the court concluded that the tangible negative rather than any of the other intangible property rights of a motion picture film such as the copyright was the valuable aspect of the film. The analogy, however, is entirely inappropriate. Unlike the automobile production machine which has an intrinsic value and potential for producing income standing by itself, with or without a patent, a motion picture negative without the right to copy or exploit it has little, if any, value.

4. As further support for its decision, the court of appeals gave "special weight" to subsequent legislative history relating to the restoration of the investment credit in 1971 (Appendix B, *infra*, pp. 13a-15a). Apart from the fact that "the views of a subsequent Congress form a hazardous basis for inferring the intent of an earlier one" (*United States* v. *Price*, 361 U.S. 304, 313),[15] the court seriously misconstrued the import of the 1971 legislative history.

While this case was still pending in the court of appeals, the view was expressed on the House floor and in the Senate Finance Committee's Report that motion picture film costs would qualify for the restored investment credit. 117 Cong. Rec. 34894; 117 Cong. Rec. 45865; S. Rep. No. 92-437, 92d Cong. 1st Sess., p. 34. While these comments support the claim that Congress intended that motion picture production costs would qualify for the restored investment credit, the court of appeals, in relying upon this history, overlooked the fact that these references to films were solely in the context of discussing *changes* in the law.[16] Indeed, under the caption "Effective

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[15] See also *United States* v. *Philadelphia Nat. Bank*, 374 U.S. 321, 348-349; *Waterman S.S. Corp.* v. *United States*, 381 U.S. 252, 269; *United States* v. *Webb. Inc.*, 397 U.S. 179, 194, n. 21; *United States* v. *Southwestern Cable Co.*, 392 U.S. 157, 170; *Rainwater* v. *United States*, 356 U.S. 590, 593; and *United States* v. *Mine Workers*, 330 U.S. 258, 280-282.

[16] The court of appeals stated that the 1971 Act did not effect a "change" in the treatment of films, because it did not change the critical phrase "tangible personal property"

dates," the Senate Report specifically states that "With respect to these provisions [which include changes "made in the treatment of: * * * motion picture and television films"], *no inference is intended* as to the proper treatment of these types of property under prior law." (Emphasis added.) S. Rep. No. 92-437, 92d Cong., 1st Sess., p. 34; see also General Explanation of the Revenue Act of 1971 (Staff of the Joint Committee on Internal Revenue Taxation), December 15, 1972, pp. 31-34.

At the very least, the consequence of the decision below will be to grant to a single industry retroactive tax relief estimated to amount to 450 million dollars. Moreover, the broad rationale of the decision could have an unsettling effect upon the applicability of both the original and the restored investment credit with respect to the costs of producing other types of creative literary property, such as books, plays and

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as used in the 1962 Act (Appendix B, *infra*, pp. 14a-15a). But it failed to recognize that identical statutory language may be construed differently when Congress desires to broaden or narrow the reach of a provision. *Commissioner* v. *Bilder*, 369 U.S. 499, 501-502, 504-505. As previously indicated, the available authorities make clear that in attributing all production costs to the intangible aspects of a motion picture, Treasury Regulations, Section 1.48-1(f), is consistent with the statutory language and the original Congressional intent that only tangible personal property qualify for the investment credit. The legislative history of the Revenue Act of 1971—reflecting an intention to make film costs eligible for the restored credit—suggests that Congress intended to expand the reach of the investment credit by carving out a legislative exception under which motion picture and television film costs are deemed to be attributable to tangible personal property.

recordings. A court should not attribute to the legislature the intention to take such a far reaching step unless there was clear evidence that it specifically intended to do so. Here, as shown above (*supra*, pp. 8-10), the legislative history of the original investment credit in 1962 shows that Congress did *not* intend to confer it upon the costs of producing motion picture films.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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DECEMBER 1973.

APPENDIX A

UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

No. 70-1296-R

[Filed May 17, 1971, Clerk, U.S. District Court, Central District of California]

WALT DISNEY PRODUCTIONS, PLAINTIFF

vs.

UNITED STATES OF AMERICA, DEFENDANT

MEMORANDUM OPINION

Plaintiff, Walt Disney Productions, brings this action for the recovery of federal income taxes paid as the result of the disallowance of claimed investment credit for negatives used by plaintiff as a producer of films for exhibition in theaters, on television and other non-theatrical entertainment. The theatrical films are entitled BIG RED and BON VOYAGE. Films prepared and marketed for television are CARNIVAL TIME, THE PRINCE AND THE PAUPER, VON DRAKE IN SPAIN, DISNEYLAND AFTER DARK, THE GOLDEN HORSESHOE REVUE and ESCAPADE IN FLORENCE.

Plaintiff, Walt Disney Productions, is a California corporation organized in 1938 to succeed to the business theretofore being operated by the late Walt Disney and his brother Roy O. Disney in three prede-

cessor corporations. Plaintiff's principal business activities since its organization has been in the production and distribution of motion picture films and the operation of an amusement park known as Disneyland in Anaheim, California. Business policy has largely limited the plaintiff to activities which are oriented to family entertainment, i.e., having appeal to adults as well as children.

It is the operation of the motion picture production facilities of plaintiff that brings before a court for the first time the applicability of the investment credit provisions of the Revenue Act of 1962 to motion picture film negatives. Production of a motion picture is an involved process of gathering together of story material, talent and production expertise and facilities to turn out a motion picture film negative. The motion picture film negative is then used to make positive prints rented to exhibitors for viewing by the public. It is the cost of creating the motion picture film negatives for the fiscal year ending September 29, 1962 in the sum of $1,416,573 that plaintiff claims is subject to the investment credit allowance. Plaintiff is properly before the court after having made claim for refund and denial of the claim by the Internal Revenue Service.

The parties have by stipulation confined the issues to be determined by the court:

> A. The factual question of whether each of the motion picture negatives which are the subject of this action had an estimated useful life of eight years or more when placed in service; and

B. The legal question of whether the motion picture negatives constitute tangible personal property.

1. THE USEFUL LIFE ISSUE:

The evidence amply supports a finding that each of the motion picture films herein had at the time of being placed in service a useful life of eight years and that plaintiff in good faith made such an estimate.

Plaintiff is engaged in the business of producing family entertainment. As such the film productions of plaintiff, unlike many other production companies, are not so-called "dated material", i.e., subject matter with an interest span limited by its content.

Experience of plaintiff with its productions prior to 1962 showed that most of plaintiff's films had an earning capacity in excess of eight years and, in fact, many had been reissued for theater showing and television exhibitions. That plaintiff was planning ahead is evidenced by the fact that films produced for showing on television in the black and white era of that medium were made in color in anticipation of color television reception now an accomplished fact.

Defendant points to the depreciation method of income forecast permitted by the Internal Revenue Code as binding upon plaintiff. Depreciation and its use as a "tax shelter" has a sufficient history to make one thing clear—that depreciation—as permitted by the tax laws—really has no true relationship to the life of the item depreciated—either useful or otherwise.

To apply depreciation method as a binding determination of "estimated useful life" required by the investment credit provisions of the Internal Revenue Code without specific limitations by the legislature is unrealistic and this Court declines the invitation to so legislate.

Defendant is not prejudiced by such a ruling since it is entitled to recapture of investment credits in the event plaintiff's useful life estimates prove to be erroneous. 26 U.S.C. § 47.

2. TANGIBLE PERSONAL PROPERTY ISSUE:

Title 26, United States Code, section 48 defines the property subject to investment credit. In pertinent part it provides:

> "§ 48. Special rules
>
> (a) Section 38 property.—
>
> (1) In general.—Except as provided in this subsection, the term 'section 38 property' means—
>
> (A) tangible personal property, or
> (B) * * *
> (C) * * *
>
> Such term includes only property with respect to which depreciation (or amortization in lieu of depreciation) is allowable and having a useful life (determined as of the time such property is placed in service) of 4 years or more."

The Congress in its enactment of the investment credit did not go beyond defining eligible property

as "tangible". Pursuant to the authority granted to the Secretary of the Treasury in Title 26, United States Code, section 38(b) to prescribe "such regulations as may be necessary to carry out the purposes of this section and subpart B", Treasury Regulations 1.48-1(c) provides for the definition of tangible personal property in essentially these terms:

> ". . . [F]or the purposes of this section, the term 'tangible personal property' means any tangible property except land and improvements thereto such as buildings or other inherently permanent structures (including items which are structural components of such building or structures). . . ."

To distinguish eligible tangible personal property, Treasury Regulations 1.48-1(f) defines intangible property as follows:

> "(f) Intangible property. Intangible property, such as patents, copyrights, and subscription lists does not qualify as section 38 property . . ."

Defendant then urges the following language of Treasury Regulation 1.48-1(f) as binding upon this Court in its consideration of the motion picture film negatives. Subsection (f) continues:

> ". . . The cost of intangible property, in the case of a patent or copyright, includes all costs of purchasing or producing *the item* patented or copyrighted. Thus, in the case of a motion picture or television film or tape, the cost of the intangible property includes manuscript and screenplay costs, the cost of wardrobe and set

design, the salaries of cameramen, actors, directors, etc., and all other costs properly includible in the basis of such film or tape. In the case of a book . . ."

Defendant in urging upon the Court the binding effect of the above-quoted language misconstrues the function of the Secretary of the Treasury in two important respects: (1) The Congress gave the Secretary the power to promulgate regulations "to carry out the purposes of the Act", not to define or redefine eligible property, and (2) the determination of what is or what is not "tangible personal property", within the meaning of the investment credit provisions of the Internal Revenue Code, is for the Court, not the Secretary of the Treasury.[1] Within its constitutional powers, the Congress could have limited the definition of "tangible personal property" for tax purposes. It did not do so. Our only alternative is to assume the Congress intended the application of the ordinary meaning of tangibility. The Secretary has no power to create a new substantive definition omitted by the legislature.

The motion picture negatives here certainly are tangible—weighing between 27 and 51 pounds, between 5000 and 11,800 feet in length and capable of being seen and touched.[2] The negatives are physic-

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[1] See *Barlow* v. *Collins*, 397 U.S. 159, 166, 25 L.Ed.2d 192, 199, 90 S. Ct. 832.

[2] Tangible—1a: capable of being touched: able to be perceived as materially existent esp. by the sense of touch. Webster's Third New International Dictionary (unabridged).

ally used in the manufacture of prints which are plaintiff's stock in trade to its consumers. It is this use which establishes the eligibility as "tangible personal property".

Regulation 1.48-1(f) suffers from yet another infirmity. When the Secretary includes in cost of copyright or patents, the "costs of purchasing or producing the item patented or copyrighted," he misconstrues the very nature of patents and copyrights.

A copyright, when secured in accordance with applicable laws is the *right* to multiply copies of a literary, intellectual or artistic property.[3] Nowhere in the constitutional or statutory scheme does the law create a right by copyright *in the property.* It is an incorporeal (intangible) right existing independently from the corporeal (tangible) property out of which it arises. *Bobbs-Merrill Co.* v. *Straus*, 210 U.S. 339, 52 L.Ed. 1086 (1907); *Stephens* v. *Cady*, 14 How. 528, 14 L.Ed. 528 (1852).

Certainly that right has value—often exceeding the intrinsic value of the tangible property copyrighted. That copyright is a separate property right treated differently for accounting purposes than the copyrighted property is recognized by the Internal Revenue Code, 26 U.S.C. § 861(a)(4); 26 U.S.C. § 1221(3). To accept defendant's interpretation of copyright property would exclude "tangible personal property" where the owner of the property in order to guarantee to himself the exclusive right to reproduce the "tangible personal property" obtains a

[3] Title 17, United States Code, Section 1 et seq.

patent or copyright. The fallacy of the major premise is obvious.

Defendant further argues that Regulation 1.48-1 (f) can be read to apply only to "prototypes", i.e., the creation of a sample of the work to determine its workability. Without deciding the applicability to copyrighted and patented articles the use of that principle here cannot withstand careful scrutiny. We are not here concerned with a prototype-experimental film. The motion picture negatives which concern us are the vehicle for creation of plaintiff's stock in trade—it is *a tool* together with the reproduction processes which allows plaintiff to produce its inventory. Without *this* negative no positive print would be available to plaintiff to carry out its everyday business.

Plaintiff's motion picture negatives are entitled to treatment as tangible personal property for the purposes of the investment credit permitted by 26 U.S.C. § 38 et seq.

3. ALLOWABLE COSTS:

Although not briefed to the Court, there is a question of allowable costs for creation of the motion picture negatives. It is the view of the Court that costs allowable for computing the investment credit are only those costs which are directly related to the finished negative. To arrive at such allocable costs, the Court finds that those costs which are not affected by the footage shot, i.e., talent on a per picture basis, costs for scenery which must be expended whether the

finished product is 5000 or 6000 feet of negative, etc. Therefore, such costs as may involve hourly labor—grips, extras, etc.—shall be allowed only in relationship the final footage of negative to be used for production of positive prints bears to the total footage shot. This arises primarily from the concern of the Court that to rule otherwise would reward inefficiency in motion picture production and certainly the cut negative cannot meet the "life span" requirements established by Congress. None of the rejected footage would qualify.

Judgment shall be for plaintiff. Final recovery to abide the parties agreeing to "allocable costs" as provided herein. Plaintiff to prepare findings of fact, conclusions of law and final judgment consistent with this opinion within 45 days.

Dated: May 17, 1971.

/s/ Manuel L. Real
MANUEL L. REAL
United States District
Judge

APPENDIX B

UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

No. 72-1052

WALT DISNEY PRODUCTIONS, APPELLANT

vs.

UNITED STATES OF AMERICA, APPELLEE

No. 72-1076

WALT DISNEY PRODUCTIONS, APPELLEE

vs.

UNITED STATES OF AMERICA, APPELLANT

[May 29, 1973]

Appeal from the United States District Court for the Central District of California

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Before: TRASK and GOODWIN, Circuit Judges, and EAST,* District Judge.

GOODWIN, Circuit Judge:

The government appeals a district court judgment in a tax-refund case allowing Walt Disney Productions to take an "investment credit" on motion-picture

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* The Honorable William G. East, United States District Judge for the District of Oregon, sitting by designation.

negatives produced in 1962. The taxpayer cross-appeals from that part of the judgment which reduced the basis of the films for purpose of the credit.

The district court held that the films were "tangible personal property" within the meaning of Internal Revenue Code of 1954; that they had a useful life of more than eight years; and that they were depreciable. The films were thus eligible for the investment credit. The Commissioner contends that the films were not "tangible personal property" within the meaning of Int. Rev. Code of 1954, § 48(a)(1)(A), and that they did not have a useful life of eight years.

The district court, in allowing Disney to take investment credit, did not allow it to take the credit on the full basis Disney used for depreciation purposes, but limited Disney to "those costs which are directly related to the finished negative," 327 F. Supp. 189, 192-93 (C.D. Cal. 1971). This figure was defined by multiplying hourly labor and certain other costs by a fraction the numerator of which was the footage of the final film and the denominator of which was the total footage shot. Disney's cross-appeal challenges this limitation of allowable costs for investment-credit purposes.

I. Investment Credit

The negatives are used to make prints, which are copyrighted, and which are exhibited in theaters or on television. The negatives are not copyrighted. They are tangible, and they are personal property. They

thus appear to be eligible for the credit. However, the Commissioner relies on Treas. Reg. § 1.48-1(f), adopted in 1964, for the proposition that all the costs of production of the negative, except the negligible costs of the raw film, are to be allocated to the intangible copyright eventually procured on the positive print. Treas. Reg. § 1.48-1(f) provides:

> "*Intangible Property.* Intangible property, such as patents, copyrights, and subscription lists, does not qualify as section 38 property. The cost of intangible property in the case of a patent or copyright, includes all costs of purchasing or producing the item patented or copyrighted. Thus, in the case of a motion picture or television film or tape, the cost of the intangible property includes manuscript and screenplay costs, the costs of wardrobe and set design, the salaries of cameramen, actors, directors, etc., and all other costs properly includible in the basis of such film or tape * * *. However, if tangible depreciable property is used in the production of such intangible property, see paragraph (b)(4) of this section."

We recognize that Treasury regulations, even interpretative regulations, "must be sustained unless unreasonable and plainly inconsistent with the revenue statutes," *Bingler* v. *Johnson*, 394 U.S. 741, 750 (1969). However, we agree with the district court that the quoted regulation is invalid. It is plainly inconsistent with the expressed purpose of the applicable statute as shown by the legislative history.

In attributing all of Disney's labor and production costs of the negatives to the copyrighted print, the regulation defeats the purpose of the credit. For example, the same regulation, if applied to a production machine in an automobile factory, would deny the investment credit on all but the material costs of a machine developed and patented for use in the manufacturing plant although the amount paid to the inventor for the idea of the machine was insignificant and the bulk of the costs of the machine were the ordinary labor and engineering costs of its production. Disney argues that its film negatives, like the hypothetical production machines, are standardized units of depreciable property which Disney uses to produce other products, the positive prints, and that the attribution of all the value of the film to the copyright, like the attribution of all the value of a machine used in production to a patent eventually procured on it, is unwarranted. We agree.

It is evident from a reading of the legislative history of the investment credit that Congress intended the credit to be allowed to those in Disney's position. Explicit statements of legislative intent that films can qualify as tangible depreciable property are found: in the Senate Finance Committee report on the 1971 restoration of the investment credit;[1] in the

[1] "As previously indicated the investment credit is generally available for depreciable tangible personal property. Questions have arisen, however, whether motion picture and television films are tangible (as distinct from intangible) personal property eligible for the credit. A court case decided the question in favor of the taxpayer. The committee agrees with

discussion in the House on the 1971 Act in a statement by Chairman Mills of the House Committee on Ways and Means in response to a specific question from the floor, 117 Cong. Rec. 34894 (1971); and in the House debates on the 1971 Act conference report, again in a statement by Chairman Mills on the House floor in response to a specific question, 117 Cong. Rec. H-12127 (daily ed. Dec. 9, 1971).

The government urges that this legislative history is irrelevant because the 1971 Act changed prior law, or at least that the history is entitled to little weight because "the views of a subsequent Congress form a hazardous basis for inferring the intent of an earlier one." *United States* v. *Price*, 361 U.S. 304, 313 (1960). However, although the 1971 re-enactment of the investment credit did change prior law in several ways, *see, e.g.*, Revenue Act of 1971, Pub. L. No. 92-178, § 104(c), 85 Stat. 497, 501, it did not change the phrase "tangible personal property" as used in the 1962 Act, Int. Rev. Code of 1954, § 48(a)(1)(A). And, while subsequent legislative history normally is not of controlling weight, it should not be ignored when it is clearly relevant. *Haynes* v. *United States*, 390 U.S. 85, 87 n.4 (1968); *Fribourg Navigation Co.* v. *Commissioner*, 383 U.S. 272, 283 (1966); *Sioux Tribe of Indians* v. *United States*, 316 U.S. 317, 329-30 (1942); *Minot Federal Savings & Loan Ass'n* v. *United States*, 435 F.2d 1368, 1371 (8th Cir. 1970).

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the court that motion picture and TV films are tangible personal property eligible for the investment credit." S. Rep. No. 92-437, 92d Cong., 1st Sess. 34, 1971 U.S. Code Cong. and Adm. News 1941 (1971).

In this case we give subsequent legislative history special weight, because the inferences flow not from Congressional action or inaction on amendatory legislation, but from explicit Congressional statements of the meaning of a phrase which was unchanged during the period in question. In addition, Representative Mills was Chairman of the House Committee on Ways and Means both in 1962 and in 1971, and many members of the Senate Finance Committee served in both years. The statements by the Finance Committee and by Chairman Mills demonstrate that the Commissioner's regulation was contrary to the Congressional intent. We hold it invalid insofar as it denied an investment credit on the films in question.

II. Extent Of Credit

The government argues that even if the films are tangible personal property they are not entitled to the full investment credit because the films did not have a useful life of eight years or more. The government relies heavily on the difference between Disney's estimates of the useful life of the films for investment credit purposes and the period computed from Disney's "income life" estimates for depreciation purposes. However, depreciation and investment credit estimates need not be the same. *Triangle Publications, Inc.*, 54 T.C. 138, 152-3 (1970), *acquiescence*, 1972-1 Cum. Bull. 2; Rev. Rul. 72-76, 1972-1 Cum. Bull. 13. The estimate of the useful life of the films presented a difficult factual problem. The district court's resolution was not "clearly erroneous."

III. Cross Appeal

Disney's cross appeal challenges the district court's ruling limiting the basis of the films for investment credit purposes to less than their basis for depreciation. We hold that this limitation was unwarranted.

There is no indication that the term "basis" as used in § 46(c)(1)(A) was to have other than its customary meaning as including the whole cost of the property produced. Int. Rev. Code of 1954, § 1012. Indeed, the requirement in § 48(g), *repealed*, Revenue Act of 1964, Pub. L. No. 88-272, § 203(a)(1), 78 Stat. 33, that the basis for purposes of depreciation shall be reduced by the amount of the investment credit compels the conclusion that "basis" was not intended to have an idiosyncratic meaning in § 46(c)(1)(A). Accordingly, the judgment of the district court is modified to allow the taxpayer to use its depreciation basis to compute its investment credit.

Affirmed as modified.

APPENDIX C

IN THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

No. 72-1052

WALT DISNEY PRODUCTIONS, PLAINTIFF-APPELLANT

v.

UNITED STATES OF AMERICA, DEFENDANT-APPELLANT

No. 72-1076

WALT DISNEY PRODUCTIONS, PLAINTIFF-APPELLEE

v.

UNITED STATES OF AMERICA, DEFENDANT-APPELLANT

Appeal from the United States District for the Central District of California. This cause came on to be heard on the transcript of the record from the United States District Court for the Central District of California and was duly submitted. On consideration whereof, it is now here ordered and adjudged by this Court that the judgment of the said District Court in this cause be and hereby is affirmed as modified.

Filed and entered May 29, 1973.

APPENDIX D

UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

[Filed Jul. 31, 1973, Dennis R. Mathews, Clerk, U. S. Court of Appeals]

No. 72-1052

WALT DISNEY PRODUCTIONS, APPELLANT

v.

UNITED STATES OF AMERICA, APPELLEE

No. 72-1076

WALT DISNEY PRODUCTIONS, APPELLEE

v.

UNITED STATES OF AMERICA, APPELLANT

Appeal from the United States District Court for the Central District of California

Before: TRASK and GOODWIN, Circuit Judges, and EAST,* District Judge.

ORDER

The panel as constituted in the above case has voted to deny the petition for rehearing and reject the suggestion for rehearing en banc.

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* The Honorable William G. East, United States District Judge for the District of Oregon, sitting by designation.

The full court has been advised of the suggestion for an en banc hearing, and no judge of the court has suggested a vote on the suggestion for rehearing en banc. Fed. R. App. P. 35(b).

The petition for rehearing is denied, and the suggestion for rehearing en banc is rejected.

APPENDIX E

Internal Revenue Code of 1954 (26 U.S.C.):

SEC 38 [as added by Sec. 2(a), Revenue Act of 1962, P.L. 87-834, 76 Stat. 960]. INVESTMENT IN CERTAIN DEPRECIABLE PROPERTY.

(a) *General Rule.*—There shall be allowed, as a credit against the tax imposed by this chapter, the amount determined under subpart B of this part.

(b) *Regulations.*—The Secretary or his delegate shall prescribe such regulations as may be necessary to carry out the purposes of this section and subpart B.

SEC. 46 [as added by Sec. 2(b), Revenue Act of 1962, *supra*]. AMOUNT OF CREDIT.

(a) *Determination of Amount.*—

(1) *General rule.*—The amount of the credit allowed by section 38 for the taxable year shall be equal to 7 percent of the qualified investment (as defined in subsection (c)).

* * * *

(c) *Qualified Investment.*—

(1) *In general.*—For purposes of this subpart, the term "qualified investment" means, with respect to any taxable year, the aggregate of—

(A) the applicable percentage of the basis of each new section 38 property (as defined in section 48(b)) placed in service by the taxpayer during such taxable year, plus

(B) the applicable percentage of the cost of each used section 38 property (as defined in section 48 (c) (1)) placed in service by the taxpayer during such taxable year.

(2) *Applicable percentage.* — For purposes of paragraph (1), the applicable percentage for any property shall be determined under the following table:

If the useful life is—	The applicable percentage is—
4 years or more but less than 6 years....	33 1/3
6 years or more but less than 8 years....	66 2/3
8 years or more	100

For purposes of this paragraph, the useful life of any property shall be determined as of the time such property is placed in service by the taxpayer.

* * * *

SEC. 47 [as added by Sec. 2(b), Revenue Act of 1962, *supra*]. CERTAIN DISPOSITIONS, ETC., OF SECTION 38 PROPERTY.

(a) *General Rule.* — Under regulations prescribed by the Secretary or his delegate—

(1) *Early disposition, etc.* — If during any taxable year any property is disposed of, or otherwise ceases to be section 38 property with respect to the taxpayer, before the close of the useful life which was taken into account in computing the credit under section 38, then the tax under this chapter for such taxable year shall be increased by

an amount equal to the aggregate decrease in the credits allowed under section 38 for all prior taxable years which would have resulted solely from substituting, in determining qualified investment, for such useful life the period beginning with the time such property was placed in service by the taxpayer and ending with the time such property ceased to be section 38 property.

* * * *

SEC. 48 [as added by Sec. 2(b), Revenue Act of 1962, *supra*]. DEFINITIONS; SPECIAL RULES.

(a) *Section 38 Property.*—

(1) *In general.*—Except as provided in this subsection, the term "section 38 property" means—

(A) tangible personal property, * * *

* * * *

Such term includes only property with respect to which depreciation (or amortization in lieu of depreciation) is allowable and having a useful life (determined as of the time such property is placed in service) of 4 years or more.

* * * *

(b) *New Section 38 Property.*—For purposes of this subpart, the term "new section 38 property" means section 38 property—

(1) the construction, reconstruction, or erection of which is completed by the taxpayer after December 31, 1961, or

(2) acquired after December 31, 1961, if the original use of such property commences with the taxpayer and commences after such date.

In applying section 46(c)(1)(A) in the case of property described in paragraph (1), there shall be taken into account only that portion of the basis which is properly attributable to construction, reconstruction, or erection after December 31, 1961.

(c) *Used Section 38 Property.*—

(1) *In general.*—For purposes of this subpart, the term "used section 38 property" means section 38 property acquired by purchase after December 31, 1961, which is not new section 38 property. Property shall not be treated as "used section 38 property" if, after its acquisition by the taxpayer, it is used by a person who used such property before such acquisition (or by a person who bears a relationship described in section 179(d)(2)(A) or (B) to a person who used such property before such acquisition).

(2) *Dollar limitation.*—

(A) *In general.*—The cost of used section 38 property taken into account under section 46(c)(1)(B) for any taxable year shall not exceed $50,000.

* * *

* * * *

(g) *Adjustments to Basis of Property.*—

(1) *In general.*—The basis of any section 38 property shall be reduced, for purposes of this subtitle other than this subpart, by an amount equal to 7 percent of the qualified investment as determined under section 46(c) with respect to such property.

* * * *

Treasury Regulations on Income Tax (1954 Code) (26 C.F.R.):

§ 1.38-1 *Investment in certain depreciable property.*

Sections 1.46-1 through 1.48-7, inclusive, are prescribed under the authority granted the Secretary or his delegate by section 38(b) of the Code to prescribe such regulations as may be necessary to carry out the purposes of section 38 and subpart B, part IV, subchapter A, chapter 1 of the Code.

§ 1.46-1 *Determination of amount.*

(a) *In general.* Except as otherwise provided in this section and in § 1.46-2, the amount of the credit allowed by section 38 for the taxable year is equal to 7 percent of the taxpayer's qualified investment for such year (as determined under § 1.46-3). The amount equal to 7 percent of qualified investment shall be referred to in this section and §§ 1.46-2 through 1.48-7 as the "credit earned".

* * * *

§ 1.46-3 *Qualified investment.*

(a) *In general.* (1) With respect to any taxable year, the qualified investment of the tax-

payer is the aggregate (expressed in dollars) of (i) the applicable percentage of the basis of each new section 38 property placed in service by the taxpayer during such taxable year, plus (ii) the applicable percentage of the cost of each used section 38 property placed in service by the taxpayer during such taxable year. With respect to any section 38 property, qualified investment means the applicable percentage of the basis (or cost) of such property. * * *

* * * *

(b) *Applicable percentage.* The applicable percentage to be applied to the basis (or cost) of property is 33⅓ percent if the estimated useful life of the property is 4 years or more but less than 6 years; 66⅔ percent if the estimated useful life is 6 years or more but less than 8 years; or 100 percent if the estimated useful life is 8 years or more. * * *

* * * *

(c) *Basis or cost.* (1) The basis of any new section 38 property shall be determined in accordance with the general rules for determining the basis of property. Thus, the basis of property would generally be its cost (see section 1012), unreduced by the adjustment to basis provided by section 48(g)(1) with respect to property placed in service before January 1, 1964, and any other adjustment to basis, such as that for depreciation, and would include all items properly included by the taxpayer in the depreciable basis of the property, such as installation and freight costs. However, for purposes of determining qualified investment, the

basis of new section 38 property constructed, reconstructed, or erected by the taxpayer shall not include any depreciation sustained with respect to any other property used in the construction, reconstruction, or erection of such new section 38 property. (See paragraph (b)(4) of § 1.48-1.

* * * *

(e) *Estimated useful life*—(1) *In general.* * * *

* * * *

(4) *Useful life of property subject to amortization.* In the case of property with respect to which amortization in lieu of depreciation is allowable, the term over which amortization deductions are taken shall be considered as the estimated useful life of such property.

(5) *Useful life of property subject to certain methods of depreciation.* If a taxpayer is using a method of depreciation, such as the unit of production or retirement method, which does not measure the useful life of the property in terms of years, he must estimate such useful life in years in order to compute his qualified investment.

* * * *

§ 1.48-1 *Definition of section 38 property.*

(a) *In general.* Property which qualifies for the credit allowed by section 38 is known as "section 38 property". Except as otherwise provided in this section, the term "section 38 property" means property (1) with respect to which depreciation (or amortization in lieu of depreciation) is allowable to the taxpayer, (2) which has an estimated useful life of 4 years or more

(determined as of the time such property is placed in service), and (3) which is either (i) tangible personal property, * * *

(b) *Depreciation allowable.* (1) Property is not section 38 property unless a deduction for depreciation (or amortization in lieu of depreciation) with respect to such property is allowable to the taxpayer for the taxable year. A deduction for depreciation is allowable if the property is of a character subject to the allowance for depreciation under section 167 and the basis (or cost) of the property is recovered through a method of depreciation, including, for example, the unit of production method and the retirement method as well as methods of depreciation which measure the life of the property in terms of years. * * *

* * * *

(4) If depreciation sustained on property is not an allowable deduction for the taxable year but is added to the basis of property being constructed, reconstructed, or erected by the taxpayer, for purposes of subparagraph (1) of this paragraph a deduction for depreciation shall be treated as allowable for the taxable year with respect to the property on which depreciation is sustained. Thus, if $1,000 of depreciation sustained with respect to property no. 1, which is placed in service in 1964 by taxpayer A, is not allowable to A as a deduction for 1964 but is added to the basis of property being constructed by A (property no. 2), for purposes of subparagraph (1) of this paragraph a deduction for depreciation shall be treated as allowable to A for 1964 with respect to property no. 1. However,

the $1,000 amount is not included in the basis of property no. 2 for purposes of determining A's qualified investment with respect to property no. 2. See paragraph (c)(1) of § 1.46-3.

(c) *Definition of tangible personal property.* If property is tangible personal property it may qualify as section 38 property irrespective of whether it is used as an integral part of an activity (or constitutes a research or storage facility used in connection with such activity) specified in paragraph (a) of this section. Local law shall not be controlling for purposes of determining whether property is or is not "tangible" or "personal". Thus, the fact that under local law property is held to be personal property or tangible property shall not be controlling. Conversely, property may be personal property for purposes of the investment credit even though under local law the property is considered to be a fixture and therefore real property. For purposes of this section, the term "tangible personal property" means any tangible property except land and improvements thereto, such as buildings and other inherently permanent structures (including items which are structural components of such buildings or structures). Thus, buildings, swimming pools, paved parking areas, wharves and docks, bridges, and fences are not tangible personal property. Tangible personal property includes all property (other than structural components) which is contained in or attached to a building. Thus, such property as production machinery, printing presses, transportation and office equipment, refrigerators, grocery counters, testing equipment, display

racks and shelves, and neon and other signs, which is contained in or attached to a building constitutes tangible personal property for purposes of the credit allowed by section 38. Further, all property which is in the nature of machinery (other than structural components of a building or other inherently permanent structure) shall be considered tangible personal property even though located outside a building. Thus, for example, a gasoline pump, hydraulic car lift, or automatic vending machine, although annexed to the ground, shall be considered tangible personal property.

* * * *

(f) *Intangible property.* Intangible property, such as patents, copyrights, and subscription lists, does not qualify as section 38 property. The cost of intangible property, in the case of a patent or copyright, includes all costs of purchasing or producing the item patented or copyrighted. Thus, in the case of a motion picture or television film or tape, the cost of the intangible property includes manuscript and screenplay costs, the cost of wardrobe and set design, the salaries of cameramen, actors, directors, etc., and all other costs properly includible in the basis of such film or tape. In the case of a book, the cost of the intangible property includes all costs of producing the original copyrighted manuscript, including the cost of illustration, research, and clerical and stenographic help. However, if tangible depreciable property is used in the production of such intangible property, see paragraph (b)(4) of this section.

* * * *

§ 1.48-2 *New section 38 property.*

(a) *In general.* Section 48(b) defines "new section 38 property" as section 38 property—

(1) The construction, reconstruction, or erection of which is completed by the taxpayer after December 31, 1961, or

(2) Which is acquired by the taxpayer after December 31, 1961, provided that the original use of such property commences with the taxpayer and commences after such date.

In the case of construction, reconstruction, or erection of such property commenced before January 1, 1962, and completed after December 31, 1961, there shall be taken into account as the basis of new section 38 property in determining qualified investment only that portion of the basis which is properly attributable to construction, reconstruction, or erection after December 31, 1961. See § 1.48-1 for the definition of section 38 property.

* * * *

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No. 73-1017
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IN THE

Supreme Court of the United States

October Term, 1973

No. 73-1017

UNITED STATES OF AMERICA,

Petitioner,

against

WALT DISNEY PRODUCTIONS,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR RESPONDENT IN OPPOSITION

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No. 73-1017

IN THE

Supreme Court of the United States

October Term, 1973

No. 73-1017

UNITED STATES OF AMERICA,
Petitioner,

against

WALT DISNEY PRODUCTIONS,
Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR RESPONDENT IN OPPOSITION

This brief is submitted on behalf of Walt Disney Productions in opposition to the petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the Ninth Circuit in this case.

QUESTION PRESENTED

Whether a writ of certiorari should issue to review the judgment below affirming the district court and holding that a motion picture negative used to manufacture prints

for exhibition is an item of "tangible personal property" for investment credit purposes [Internal Revenue Code of 1954, §§ 38, 46, 47 and 48] solely because petitioner asserts, without any support in the record, that it will sustain a very large revenue loss unless that judgment is reversed, where there is no conflict between circuits or with decisions of this Court, where the decision below was unanimous and no judge of the Ninth Circuit suggested a vote on petitioner's suggestion for rehearing *en banc*, and where the pertinent legislative history overwhelmingly supports and expressly approves the result reached by the district and circuit courts.

COUNTER-STATEMENT

Petitioner's statement of the case is incomplete and misleading and inaccurately summarizes the holdings of the two courts below, as will appear from the following counter-statement:

Disney's principal business activities since its organization in 1938 have been the production and distribution of motion picture films oriented to family entertainment and the operation of family recreational centers. The record in the district court establishes that Disney's completed motion picture film negatives are used to manufacture, or "strike," positive prints which are then shown in theatres, on television, or in homes, schools, and other places of non-theatrical entertainment.[1] A positive print can only be used for a limited number of exhibitions before becoming

[1]Petitioner refers to the use of the matrix to make prints. Pet. at 3. Each matrix, itself a form of positive print made directly from the negative, can be used to strike from 20 to 75 prints before wearing out, at which time another matrix must be made. The matrix merely preserves the useful life of the negative [R. 67]. (For the form of citations, see note 2 *infra*.)

worn; at that point, replacement prints must be manufactured in order to continue exhibition [R. 893].[2]

On its income tax return for its fiscal year ended September 29, 1962, Disney claimed an investment credit in the amount of $99,160 on the cost of producing eight such negatives. The Internal Revenue Service disallowed the claimed credit, Disney filed a claim for refund which the Internal Revenue Service disallowed, and the refund suit followed in the district court.

The district court ruled that "[t]he evidence amply supports" a finding of fact that each of the negatives "had at the time of being placed in service a useful life of eight years." *Walt Disney Productions* v. *United States,* 327 F. Supp. 189, 190 (C.D. Cal. 1971); Pet. App. A at 3a. The district court also held that the negatives were "tangible personal property" within the meaning of section 48(a)(1)(A) of the Internal Revenue Code:

> "The motion picture negatives here certainly are tangible—weighing between 27 and 51 pounds, between 5000 and 11,800 feet in length and capable of being seen and touched. The negatives are physically used in the manufacture of prints which are [Disney's] stock in trade to its consumers. It is this use which establishes the eligibility as 'tangible personal property.'" 327 F. Supp. at 192; Pet. App. A at 6a-7a (footnote omitted).

In arguing that the negatives were not tangible the Government relied on an example contained in section 1.48-1(f) of the Income Tax Regulations, which provides in pertinent part:

---

[2] Throughout this brief "R." references are to the duplicated volumes of the record on appeal; "Pet." references are to the Petition for Certiorari; "Pet. App." references are to the appropriate Appendix to the Petition for Certiorari.

> "The cost of intangible property, in the case of a patent or copyright, includes all costs of purchasing or producing the item patented or copyrighted. Thus, in the case of a motion picture or television film or tape, the cost of the intangible property includes manuscript and screenplay costs, the cost of wardrobe and set design, the salaries of cameramen, actors, directors, etc., and all other costs properly includible in the basis of such film or tape." Treas. Reg. § 1.48-1(f)(1964).

The district court held that the regulation was invalid since it improperly ascribed to the intangible statutory copyright the costs of producing the tangible negatives. After noting that the intangible copyright "is the *right* to multiply copies of a literary, intellectual or artistic property" [327 F. Supp. at 192; Pet. App. A at 7a (emphasis in original)], the court stated:

> "To accept [petitioner's] intrepretation of copyright property would exclude 'tangible personal property' where the owner of the property in order to guarantee to himself the exclusive right to reproduce the 'tangible personal property' obtains a patent or copyright. The fallacy of the major premise is obvious." 327 F. Supp. at 192; Pet. App. A at 7a-8a.

The district court went on to observe that:

> "We are not here concerned with a prototype-experimental film. The motion picture negatives which concern us are the vehicle for creation of [Disney's] stock in trade—it is *a tool* together with the reproduction processes which allows [Disney] to produce its inventory. Without *this* negative no positive print would be available to [Disney] to

> carry out its everyday business." 327 F. Supp. at 192; Pet. App. A at 8a (emphasis in original).

On appeal, the court of appeals sustained the district court's useful life findings and also declared the regulation to be invalid as "plainly inconsistent with the expressed purpose of the applicable statute as shown by the legislative history." *Walt Disney Productions* v. *United States,* 480 F. 2d 66, 68 (9th Cir. 1973); Pet. App. B at 12a. The court stated:

> "In attributing all of Disney's labor and production costs of the negatives to the copyrighted print, the regulation defeats the purpose of the credit. . . . Disney argues that its film negatives, like the hypothetical production machines, are standardized units of depreciable property which Disney uses to produce other products, the positive prints, and that the attribution of all the value of the film to the copyright, like the attribution of all the value of a machine used in production to a patent eventually procured on it, is unwarranted. We agree." 480 F. 2d at 68; Pet. App. B at 13a.

REASONS FOR DENYING THE PETITION

The status of Disney's negatives as "tangible personal property" is a simple, clear-cut issue, limited to the years 1962-1969, which has been resolved against petitioner by Congress and by two courts below. There is no conflict between the circuits or with other decisions of this Court.[3] Consequently, petitioner's unsupported statements

[3] There is a possibility of conflict in the future. In addition to Disney's cases, there are, according to petitioner, five other cases in litigation, each of which is pending in the Court of Claims. Pet. at 6 n.5.

concerning its assumed revenue loss are especially irrelevant in determining whether a writ of certiorari should issue.[4]

1. Petitioner's claims concerning assumed revenue losses do not furnish any responsible support for a petition for certiorari on the record and in the circumstances of this case.

There is no basis in the record or in the petition to support petitioner's grossly exaggerated estimates of the fiscal significance of this case.[5] And even if there were, it does not at all follow that the number of dollars involved has any bearing on the correctness of the decision below, or on the necessity of its review by this Court.

Moreover, it is premature for petitioner to state, solely on the basis of its experience in this case, that if negatives qualify for the credit there will be a revenue loss measured

[4] Petitioner knows well that revenue loss is not surprising in the context of the investment credit provisions. Over $16 billion of useable credits have been claimed from the inception of the investment credit in 1962 through taxable years ended in June, 1970. U. S. Department of Treasury, Internal Revenue Service, *Statistics of Income, Corporation Income Tax Returns, 1962* at 49, *1963* at 54, *1964* at 46, *1969* (*Preliminary*) at 35; U. S. Department of Treasury, Internal Revenue Service, *Statistics of Income, Individual Income Tax Returns, 1970* at 309. This is in line with the estimate made by the Joint Committee on Internal Revenue Taxation in 1962 that the revenue loss generated by the investment credit for the years 1962 to 1972 would exceed $20 billion. 108 Cong. Rec. 21765 (1962). *See also* S. Rep. No. 1881, 87th Cong., 2d Sess. 7-8 (1962); H. R. Rep. No. 1447, 87th Cong., 2d Sess. 4-5 (1962).

[5] Without knowing how petitioner arrived at its varying estimates, Disney cannot effectively challenge those figures. It would be interesting to know, for example, how many of the more than 500 production companies which petitioner states are located in the Ninth Circuit have filed timely claims for refund and, if so, in what amounts and whether any of those taxpayers aside from Disney have commenced suit thereon. Disney's tax personnel, knowledgeable in the industry, believe, on the basis of their expertise, that the actual revenue loss would be only a small fraction of the potential figures alleged by petitioner.

by seven percent of "virtually all of the costs of motion picture production from 1962 through 1969."[6] Pet. at 5. In view of the special circumstances of this case, that can be true only if every taxpayer can establish a useful life of eight or more years for each negative.[7]

The district court concluded that Disney's negatives each had a useful life of eight years only after finding that "the film productions of [Disney], *unlike many other production companies,* are not so-called 'dated material' . . . ." 327 F. Supp. at 190; Pet. App. A at 3a (emphasis added). On appeal petitioner unsuccessfully challenged the district court's useful life findings and at present petitioner is challenging Disney with respect to the useful life of each negative made by Disney during its fiscal years 1963 through 1969.[8] Petitioner, however, has not tested this issue with respect to any other production company. Until it does, it has no justifiable basis for its estimate of the sheer dollar importance of this case. Accordingly, those estimates should not be considered in determining whether the petition should be granted.

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[6] Disney also fails to understand petitioner's concern that, if negatives qualify as tangible personal property, a portion of overhead costs will qualify for the credit. Pet. at 7-8. Petitioner does not contest the holding of the court of appeals that the basis of each negative for investment credit purposes must be the same as its basis for depreciation purposes. Accordingly, the only overhead expenses which could be subject to the credit would be those which are properly allocable to the negative for depreciation purposes in accordance with standard accounting methods. Petitioner has never objected to the inclusion of such costs in the basis of negatives for depreciation purposes; accordingly, it has no grounds for its objection to their inclusion for investment credit purposes.

[7] To the extent useful life is less than eight years the credit is reduced or, if less than four years, is eliminated. Int. Rev. Code of 1954, § 46(c)(2). Also, the credit cannot be claimed unless the taxpayer has the requisite tax liability. Int. Rev. Code of 1954, § 46 (Appendix A *infra*).

[8] *Walt Disney Productions* v. *United States,* Civil Docket No. 73-2125 (C.D. Cal., filed Sept. 7, 1973).

2. The decisions below are clearly and entirely consistent with, if not mandated by, the legislative history of the investment credit provisions.

When the investment credit was originally adopted in 1962 both the Senate Committee on Finance and the House Committee on Ways and Means stated that, except for certain statutory exclusions not applicable to this case, "*all* tangible personal property qualifies" for the credit, further directing that "*[t]angible personal property is not intended to be defined narrowly here . . . .*" S. Rep. No. 1881, 87th Cong., 2d Sess. 16 (1962); H. R. Rep. No. 1447, 87th Cong., 2d Sess. 11 (1962) (emphasis added).

This specific direction by Congress followed from the underlying legislative purpose of the investment credit provisions to "provide a strong and lasting stimulus to a high rate of economic growth and . . . an incentive to invest comparable to those available elsewhere in the rapidly growing industrial nations of the free world." H. R. Rep. No. 1447 at 8. *See also* S. Rep. No. 1881 at 11. In recognition of this purpose, the courts of appeals in the Second, Seventh, Eighth and Tenth Circuits, as well as the Tax Court, each have held that the investment credit provisions should be interpreted liberally when determining whether investment in a particular type of property qualifies for the credit.[9] No court has held to the contrary.

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[9] *King Radio Corp., Inc.* v. *United States*, 486 F. 2d 1091 (10th Cir. 1973) ("We think that it was the intent of Congress to extend the investment tax credit to as broad a segment of American industry as possible . . . ." *Id.* at 1096); *Minot Federal Savings & Loan Ass'n* v. *United States*, 435 F. 2d 1368 (8th Cir. 1970) ("The statutes and regulations in such matters should be liberally construed consistent with the legislative purpose behind the investment credit statute." *Id.* at 1372); *Northville Dock Corp.* v. *Commissioner*, 427 F. 2d 164 (2d Cir. 1970), *aff'g per curiam* 52 T.C. 68, 73 (1969); *Commissioner* v. *Schuyler Grain Co., Inc.*, 411 F. 2d 649, 652 (7th Cir. 1969), *aff'g* 50 T.C. 265, 269-270 (1968), *acquiesced in*, 1971-2 Cum. Bull. 3; *Beverly R. Roberts*, 60 T.C. No. 91 (Sept. 6, 1973); *accord, Norfolk Shipbuilding & Drydock Corp.* v. *United States*, 321 F. Supp. 222 (E.D. Va. 1971); *F. P. Wood & Son of Elizabeth City, Inc.* v. *United States*, 314 F. Supp. 1205 (E.D. N.C. 1970).

In 1962 Congress also specifically stated that the investment credit was designed to stimulate the growth of national productivity and output, increase the competitiveness of U. S. exports, and aid in correcting an imbalance in the U. S. balance of payments. S. Rep. No. 1881 at 1-2, 10-12; H. R. Rep. No. 1447 at 7-8. Allowing the investment credit with respect to motion picture negatives accomplishes each of those objectives.

The legislative history of the Revenue Act of 1971, Pub. L. No. 92-178, 85 Stat. 497, also makes it absolutely clear that motion picture and television negatives are intended to qualify for the credit. The Senate Committee on Finance specifically approved the district court's holding in this case, stating:

> *"Motion picture and television films.*—As previously indicated the investment credit is generally available for depreciable tangible personal property. Questions have arisen, however, whether motion picture and television films are tangible (as distinct from intangible) personal property eligible for the credit. *A court case decided the question in favor of the taxpayer. The committee agrees with the court that motion pictur and TV films are tangibl personal property eligible for the investment credit."* S. Rep. No. 92-437, 92d Cong., 1st Sess. 34 (1971) (emphasis added).

In addition, Chairman Mills of the House Committee on Ways and Means twice stated on the floor of the House that the costs of producing a motion picture film qualify for the investment credit. 117 Cong. Rec. 34894 (1971); 117 Cong. Rec. 45865 (1971).

Petitioner no longer argues, as it did before the Ninth Circuit, that this subsequent legislative history is of "no

relevance."[10] Rather, petitioner argues that the Ninth Circuit should not have assigned "special weight" to this legislative history since Congress intended no inference as to the eligibility of negatives for the credit prior to 1971. Pet. at 16-18. We totally disagree with petitioner's analysis of the "Effective dates" paragraph of the Senate report.[11] Pet. at 16-17. However, even if one were to assume that

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[10] This Court has often held that subsequent legislative history may be considered in interpreting prior legislation on the same subject. *Haynes* v. *United States,* 390 U. S. 85, 87-88 n.4 (1968); *Fribourg Navigation Co.* v. *Commissioner,* 383 U. S. 272, 283-86 (1966); *Great Northern Ry.* v. *United States,* 315 U. S. 262, 277 (1942); *Tiger* v. *Western Investment Co.,* 221 U. S. 286, 309 (1911). *See also Minot Federal Savings & Loan Ass'n* v. *United States, supra* note 9; *Bobsee Corp.* v. *United States,* 411 F. 2d 231 (5th Cir. 1969).

In *Sioux Tribe of Indians* v. *United States,* 316 U. S. 317 (1942), the Court was interpreting an 1887 statute. The same Senate Committee which had reported on the 1887 statute issued a report in 1892 in connection with an act on the same general subject passed that year; the 1892 report contained a statement of the Senate Committee's view on the meaning of the 1887 statute. The Supreme Court stated:

> "This statement made by the Committee which reported the . . . Act of 1887, made within five years of its passage, is virtually conclusive as to the significance of that Act." *Id.* at 329-30.

[11] A study of the entire portion of the Senate report (Appendix B *infra*), from which petitioner has quoted only selected language, indicates that the reference to films was an obvious error of draftsmanship. It refers only to "changes" in the definitions of qualifying property "made by" section 104 of the Revenue Act of 1971 and to the "provisions" of that section. However, section 104 of the Act made no "change" and contained no "provision" relating to motion picture and television films. Nor are there any published drafts of section 104 of the 1971 Act containing such language. Rather, the only section of the Code which could relate to films—section 48(a)(1)(A), relating to "tangible personal property"—was left "as is." As shown in the table set forth in Appendix C *infra,* as reproduced from Disney's Answering Brief in the Ninth Circuit, as to *every other* type of property but films listed in the "Effective dates" portion of the Senate Report, section 104 of the 1971 Act worked a specific change in the language of one of the existing subsections of section 48 of the Internal Revenue Code.

Congress did not intend explicitly to decide the issue presented in this case, the court below correctly attributed particular significance to the 1971 legislative history, considering that (i) the relevant statutory language—the phrase "tangible personal property" in section 48(a)(1)(A)—has remained unchanged from 1962 through restoration of the investment credit by the Revenue Act of 1971, and to the present time;[12] (ii) seven members of the Senate Committee on Finance served on that committee both in 1962 and 1971, and Representative Mills chaired the House Committee on Ways and Means during both years;[13] (iii) rather than tacitly approving section 1.48-1(f) of the Income Tax Regulations, which would deny Disney the investment credit, Congress, in restoring the investment credit provisions in 1971, specifically disapproved the content of that regulation; and (iv) there is no persuasive reason why the language "tangible personal property" as applied to motion picture and television negatives should have one meaning in 1962 and another in 1971.[14]

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[12] The credit was suspended as to property constructed or acquired within the period beginning on October 10, 1966, and ending on March 9, 1967. In 1969, the credit was generally terminated for property acquired after April 18, 1969, and for property the construction of which began after that date. The next step in the history of the investment credit was its restoration in 1971.

[13] *Congressional Directory*, 87th Cong., 2d Sess. 235, 253; *Congressional Directory*, 92d Cong., 1st Sess. 254, 276.

[14] Petitioner mistakenly relies upon *Commissioner* v. *Bilder*, 369 U. S. 499 (1962), to support a proposition that identical statutory language may be construed differently when Congress desires to broaden or narrow the reach of a provision. Pet. at 17 n.16. Unlike here, that case involved the ***re-enactment*** of a statute [Internal Revenue Code of 1939, § 23(x) re-enacted as Internal Revenue Code of 1954, § 213] accompanied by a ***change*** in the language of the statute (where Congress added the word "transportation" to the category of deductible medical expenses and stated in the relevant committee reports that the costs of lodging were no longer deductible).

The court of appeals was clearly correct, therefore, when it held that the 1971 legislative history—consisting, as it does, of "explicit Congressional statements of the meaning of a phrase which was unchanged during the period in question"—demonstrates that the regulation "was contrary to the Congressional intent."[15] 480 F. 2d at 69; Pet. App. B at 15a. Consequently, both courts below properly declared section 1.48-1(f) of the Income Tax Regulations, which characterizes motion picture negatives as intangible property, to be invalid.[16]

The invalidity of the regulation arises from its failure to recognize that a motion picture negative in Disney's field of endeavor is the equivalent of a machine. This factual

[15] Petitioner's reliance on the King bill [Pet. at 10], which died in committee in 1963, is misplaced. Numerous decisions of this Court clearly state that it is improper in statutory interpretation cases to attach weight to statements made in connection with legislation not enacted. As this Court has explained, to ascribe such significance to bills not enacted into law would deter individuals and institutions—particularly governmental bodies—from seeking desirable legislative guidance and clarification. *United States* v. *W. M. Webb, Inc.*, 397 U. S. 179, 194 n.21 (1970); *United States* v. *Southwestern Cable Co.*, 392 U. S. 157, 169-70 (1968); *Waterman S. S. Corp.* v. *United States*, 381 U. S. 252, 268-69 (1965); *United States* v. *Price*, 361 U. S. 304, 310-12 and n.7 (1960).

[16] The court of appeals expressly recognized that Income Tax Regulations should be sustained unless unreasonable or plainly inconsistent with Congressional purpose. 480 F. 2d at 68; Pet. App. B at 12a. Neither *Brewster* v. *Gage*, 280 U. S. 327 (1930), nor *Lucas* v. *American Code Co.*, 280 U. S. 445 (1930), support petitioner's contention that regulations issued pursuant to a grant of authority as general as that contained in section 38(b) are to be regarded as legislative regulations. Pet. at 11 n.11. Former Assistant Secretary of the Treasury Surrey observes that the weight accorded regulations depends upon the type of statutory language authorizing the regulations. He concludes that regulations issued pursuant to a statutory standard of the type set forth in section 38(b) are hardly legislative regulations; in fact, they are "no more than the Department's construction of the Revenue Act," without "any authority." Surrey, *The Scope and Effect of Treasury Regulations under the Income, Estate, and Gift Taxes*, 88 U. PA. L. REV. 556, 557-58 (1940).

determination was resolved in favor of Disney and against petitioner by both the district court and the Ninth Circuit. The district court recognized that each negative is "physically used in the manufacture of prints which are [Disney's] stock in trade" and properly characterized each negative as "*a tool* together with the reproduction processes which allows [Disney] to produce its inventory." 327 F. Supp. at 192; Pet. App. A at 6a-7a, 8a (emphasis in original). The court of appeals agreed that Disney's "film negatives, like the hypothetical production machines, are standardized units of depreciable property which Disney uses to produce other products, the positive prints." 480 F. 2d at 68; Pet. App. B at 13a. Both courts thus held that there is no basis for concluding, as the regulation did, that the production costs of the tangible negative are incurred to obtain the intangible copyright.

Disney incurs its production costs to manufacture a productive tangible asset, the negative, which is physically used to manufacture its inventory. It does not incur those costs to secure a copyright on the photoplay. It is Disney's ownership and possession of the negative—not the copyright—which give it the unlimited right to strike prints, and it is Disney's ownership and possession of the prints which give it the unlimited right to rent the prints to exhibitors or to license others to do so.[17] The rights flowing

[17] The copyright on the photoplay does not, as petitioner repeatedly and erroneously contends, bestow upon the owner of a negative the right to distribute and exhibit prints manufactured from the negative. Furthermore, the cases cited by petitioner fail to suport the proposition that all of the value of a film negative is attributable to the copyright on the photoplay. We agree completely, for example, with the statement in *Misbourne Pictures Limited* v. *Johnson*, 189 F. 2d 774 (2d Cir. 1951), relied on by petitioner [Pet. at 13], that possession of a negative without rights of distribution would be of "relatively little value." *Misbourne Pictures Limited* at 776. Disney, as owner and sole possessor of its negatives, has *both* possession of the negatives and the right to control their use.

from such ownership and possession do not convert the negative into intangible property any more than the rights associated with ownership and possession of a printing press render it intangible.

The common law copyright affords no protection to the economic value of Disney's films since all of its films are made for immediate public exhibition. The statutory copyright, which is obtained after the negatives are completed, also does not significantly protect the economic value of the films both because the extent of the statutory copyright protection is quite limited as applied to Disney's films and because Disney, as owner of the negatives, has sufficient legal remedies aside from the copyright to preserve at all times their essential economic value.[18]

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[18] As owner and possessor of its negatives, Disney has tort remedies against one who steals its negatives or prints and both contract and tort remedies against one who lawfully has possession of its prints but who unlawfully makes and commercially exploits a duplicate negative or additional prints therefrom. As was the essence of the holding in *Michael Todd Co.* v. *County of Los Angeles*, 16 Cal. Rptr. 921 (Dist. Ct. App. 2d Dist. 1961), *aff'd*, 57 Cal. 2d 684, 371 P. 2d 340, 21 Cal. Rptr. 604 (1962), an owner's common law property rights with respect to a negative are sufficient to preserve the essential economic value of the negative and prints made from it.

Statutory copyright protection does prevent a competitor from plagiarizing a Disney-owned negative by producing his own negative with his own film, his own cast, his own studio, and substantial amounts of his own money. Obviously, this seldom, if ever, occurs. The statutory copyright does not provide even this protection against another producer who uses public domain material on which a Disney film is based or with respect to nature films, films depicting geographical locations, and films based on public or historical events. Given the nature of Disney's business—family entertainment—many of its films fall into one or more of these categories. The other advantages of the statutory copyright are original jurisdiction in federal courts, statutory damages, and certain evidentiary and procedural advantages [28 U. S. C. § 1338(a); 17 U. S. C. §§ 101, 209, 210]; these bolster Disney's exclusive rights to deal with its negatives and prints as it sees fit, but they surely provide no basis for attributing the costs of making the negatives to the statutory copyright.

Similarly, petitioner has no basis for its effort to avoid the compelling legislative history of the investment credit provisions by urging that the words "construction, reconstruction, or erection" in section 48(b) of the Internal Revenue Code of 1954 somehow limit the type of tangible personal property eligible for the credit. Pet. at 9-10. Section 48(b) does not define the *kind* of property eligible for the credit. That section merely deals with *when* a taxpayer must buy or make property in order to qualify for the credit; it provides that the taxpayer may only claim a credit for new property:

> "(1) the construction, reconstruction, or erection of which is completed by the taxpayer after December 31, 1961, or
>
> "(2) acquired after December 31, 1961, if the original use of such property commences with the taxpayer and commences after such date."

It is section 48(a)(1)(A) which defines the kind of property that qualifies for the credit—"tangible personal property"—and the language in the temporal provisions of section 48(b) is of no significance in interpreting that phrase.[19]

[19] We are unaware of any previous instance where petitioner has taken the view that the words "construction, reconstruction, or erection" in section 48(b) redefine the kinds of property eligible for the credit. Indeed, if section 48(b) is definitional, petitioner's position leads to absurd results. For example, a publisher who incurs costs for offset-lithography films and electroplates used in the production of a copyrighted book is entitled to claim a credit for investment in "tangible personal property" under Revenue Ruling 70-403, 1970-2 Cum. Bull. 3. Under petitioner's reading of section 48(b), however, the publisher only secures the credit if he incurs the cost of those items by purchasing them rather than by producing them himself.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted,

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Appendix A

STATUTES AND REGULATIONS INVOLVED

Pertinent Statutes and Regulations are set forth in the petition. Pet. App. E. at 20a-30a. Also relevant is the following statutory provision:

Internal Revenue Code of 1954:

> "SEC. 46 [as added by Sec. 2(a), Revenue Act of 1962, Pub. L. No. 87-834, 76 Stat. 960].
>
> AMOUNT OF CREDIT.
>
> "(a) *Determination of Amount.*—
>
> * * *
>
> "(2) *Limitation based on amount of tax.*—Notwithstanding paragraph (1), the credit allowed by section 38 for the taxable year shall not exceed—
>
> "(A) so much of the liability for tax for the taxable year as does not exceed $25,000, plus
>
> "(B) for taxable years ending on or before [March 9, 1967], 25 percent of so much of the liability for tax for the taxable year as exceeds $25,000, or
>
> "(C) for taxable years ending after [March 9, 1967], 50 percent of so much of the liability for tax for the taxable year as exceeds $25,000."
>
> * * *
>
> [NOTE: For applicable carryback and carryover periods with respect to unused credits, see section 46(b).]

Appendix B

EFFECTIVE DATES PROVISION OF SENATE REPORT ON REVENUE ACT OF 1971

S. Rep. No. 92-437, 92d Cong., 1st Sess. 34 (1971):

> "In general, *the changes made by this section* [*104*] *of the* [*1971*] *bill* are to apply only to qualifying property [defined earlier as tangible personal property acquired, constructed, reconstructed, or erected by the taxpayer after August 15, 1971]. *These changes* include those made in the treatment of: storage facilities; coin-operated machines in apartment buildings; property used outside the United States in connection with exploring or extracting natural resource deposits from ocean waters or submarine deposits or the furnishing of telephone service; livestock; property subject to special amortization; and *motion picture and television films. With respect to these provisions,* no inference is intended as to the proper treatment of these types of property under prior law." (Emphasis added.)

Appendix C

AMENDMENTS OF SECTION 48 OF THE CODE MADE BY SECTION 104 OF THE REVENUE ACT OF 1971.

Type of Property:	*Covered by Code Section:*	*Amendment made by Revenue Act of 1971 Section:*
Comsat	48(a)(5)	104(c)(1)
	48(a)(2)(B)(viii)	104(c)(2)
Railroad track	48(a)(9)	104(g)
Storage facilities	48(a)(1)(B)(iii)	104(a)(1)
Coin-operated machines in apartment buildings	48(a)(3)(C)	104(b)(3)
Property used outside U.S. for underwater exploration, extracting or telephone service	48(a)(2)(B)(x)	104(d)
	48(a)(2)(B)(ix)	104(c)(3)
Livestock	48(a)(6)	104(e)
Property subject to special amortization	48(a)(8)	104(f)(1)
Motion picture and television films	48(a)(1)(A)	None